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SUBJECT: ALITALIA STILL FLIES UNDER THE ITALIAN FLAG BUT AT  
A HIGH COST TO ITALY

Classified By: Economic Mi...

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A HIGH COST TO ITALY

Classified By: Economic Minister Counselor Tom Delare  
for reasons 1.4 (b, d)

¶1. (C) Summary: Prime Minister Berlusconi appears to have achieved his campaign promise to save Alitalia and keep it Italian. On September 29 the last of Alitalia's nine unions signed onto a deal for a consortium of Italian business to purchase the carrier. This signals an end to the almost two-year struggle to save the dying airline, but it remains to be seen whether the deal will benefit Italian travelers. The new airline will hold a defacto monopoly on intra-Italy routes, and the debts and liabilities of Alitalia will now become part of a "bad company," headed for liquidation but still owned by the government. As the business of reorganizing the company begins, the new Alitalia, now known as Cai (Compagnia Aerea Italiana), still faces an uphill battle to return to profitability and to convince ordinary Italians and opposition politicians that the cost was worth it. The saga is a reminder of the many problems that bedevil Italy's business environment. End Summary.

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"ITALIANITA" SUCCEEDS, BUT WAS IT GOOD BUSINESS?  
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¶2. (U) During the spring 2008 election campaign, then-candidate Berlusconi weighed in on the Alitalia sale declaring that the airline should remain "Italian." Unions immediately saw a chance to get a better deal than that being offered by Air France-KLM, which was at that point considering a buyout. The Air France-KLM deal collapsed in the wake of Berlusconi's pronouncements and union opposition. Having scuttled the deal, PM Berlusconi was under obvious political pressure to somehow save Alitalia. Among government officials, only the Minister of the Interior publicly admitted that losing a flag carrier wouldn't have been a tragedy, but Berlusconi remained opposed to anything but an Italian buyer.

¶3. (U) To provide his Italian solution, Berlusconi used his personal and political skill to convince a group of wealthy Italian businessmen to commit to "rescuing" the airline and preserving Italy's flagship carrier. The group of 16 investors formed Cai(Compagnia Aerea Italiana) and determined to follow a plan of purchase designed by Intesa Sanpaolo, one of Italy's largest banks (and also a Cai investor).

¶4. (U) To make Cai into a profitable company, they'll have help from recent tailor-made changes to Italian bankruptcy law that will allow the company to be split into two, with

the liabilities and debts of 1 billion Euros remaining in the "bad company," which will be the responsibility of the GOI. Cai will keep the profitable portions and will also be allowed to hold a defacto monopoly on the profitable Rome-Milan route, as well as other intra-Italy routes. Alitalia previously competed with Air One on these routes, but Air One will be folded into Alitalia as part of Cai's purchase deal. Competition for Cai could come in the form of the new high-speed train running between Rome and Milan, set to start in 2009. It could also come from foreign carriers operating under the Open Skies agreement.

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THE INVESTORS OF CAI - CAPITALISTS OR CRONIES?  
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¶5. (SBU) Cai is made up of 16 Italian investors, among them top names of Italian business such as Gilberto Benetton, of the fashion company; Roberto Colaninno, chairman and CEO of scooter maker Piaggio; and Emilio Riva, whose business is steel. The Benetton family is investing in Alitalia through the toll-road company Atlantia, which its investment firm controls. The Benettos also hold a controlling interest in the company that runs Rome's airports. Another Cai investor already has business interests at Milan's two airports. Roberto Colaninno and Rocco Sabelli, two key players at Cai, come from Piaggio. Colaninno leads the investor group and will be Chairman of Cai. Sabelli, his right-hand man, will be CEO. They are known for a successful turnaround of the scooter company. Other investors are in businesses ranging from cruise ships to steel to telecommunications, opening the possibility for preferential treatment of their companies from the GOI in return for the Alitalia bailout. Not all of the investors are personally or politically close to Berlusconi, but all will likely consider the PM to owe them favors. The exact nature of these favors has been, and likely will continue to be, a subject of lively media interest.

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AN INTERNATIONAL PARTNER STILL NEEDED  
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¶6. (U) The plan to save Alitalia has always envisioned the participation of an international partner, but that partner will be a minority stakeholder. Both Air France-KLM and Lufthansa are meeting with union officials and speaking with Cai representatives as they explore the possibility of purchasing a 10-20% stake.

¶7. (U) Though the Berlusconi government's primary concern in negotiations over sale of the airline was that it remain Italian, the government has now said that the choice of a minority partner is up to Cai and that it will be a market-based choice. Newspapers speculate that a Lufthansa partnership would favor using Milan as a hub, while Air France-KLM would favor Rome. The Lega Nord political party, Berlusconi's coalition partner, has publicly announced it favors Lufthansa.

ADDITIONAL STUMBLING BLOCKS

¶8. (SBU) Newspaper reports have pointed to obstacles that could cause Cai to stumble.

The EU will still examine the deal to ensure a true "discontinuity" between the new company and the old and to confirm transparency in the handover. Cai also still needs to obtain a license, since the current license is held by Alitalia. Marino Barzaghi, administrative counselor to the president of Italy's civil air authority, in a phone call with embassy staff dismissed these concerns as journalistic speculation. He says all issues concerning the EU are procedural and should not pose any problems. He said he does not foresee any disruption of the airline's service while the changeover occurs. Ryan Air however has moved to block the deal. Newspapers reported Oct. 2 that the Irish budget airline has filed a complaint with the EU, saying that

by allowing debts to remain the responsibility of the government, the GOI is illegally protecting a failing company. Ryan Air representatives have said they'll take the issue to court if the EU Commission allows the sale.

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COMMENT  
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19. (C/NOFORN) The Alitalia saga is a sad reminder of how things work in Italy and of PM Berlusconi's rather weak adherence to some of the core principles of free-market capitalism. Berlusconi had the chance to let this be handled as a business matter, but he chose to politicize it. Under the guise of a rather quaint (and distinctly un-EU) desire to maintain the Italian-ness of the company, a group of wealthy Berlusconi cronies was enticed into taking over the healthy portions of Alitalia, leaving its debts to the Italian taxpayers. The rules of bankruptcy were changed in the middle of the game to meet the government's needs. Berlusconi pulled this one off, but his involvement probably cost the Italian taxpayers a lot of money. The way in which this deal was done -- cronies, political interference, preference for Italian buyers, custom-made laws -- provided the world with a clear reminder of Italy's investment climate shortcomings. End Comment.  
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